Reserved

Writ Petition No. 806 (M/B) of 2002.

Oil & Natural Gas Corporation Ltd.,
Dehradun .....Petitioner

Versus

Deputy Commissioner,
Income-Tax, Dehradun and others ...Respondents

.....

Hon. Irshad Hussain, J.
Hon. M. M. Ghildiyal, J.

(Delivered by Hon. Irshad Hussain, J)

The petitioner is this petition took exception to and questioned noticed dated 29.05.2001 (Annexures marked as Exts. '13' to '17') issued under section 147 read with section 148 of the Income Tax Act, 1961 (hereinafter for short the 'Act') in regard to assessment years 1991-92; 1992-93; 1993-94 and 1994-95 and the challenge to the notices is mainly on the ground that these have been issued after the expiry of four years from the end of the relevant assessment year even though the conditions as contemplated under section 147 of the Act were not satisfied.

The relevant facts briefly stated are :-

The petitioner is a public limited company incorporated under the Companies Act, 1956 and is the successor of erstwhile Oil & Natural Gas Commission whose entire undertaking was transferred to the petitioner vide the 'Oil & Natural Gas Commission (Transfer of Undertaking and Repeal) Act, 1993' with effect from 01.02.1994. The assessment for the relevant assessment years were completed under section 143(3) of the Act. The assessing officer made a disallowance of 10% of the tax free interest earned on bonds on the ground that it relates to the expenditure incurred by the petitioner in earning the said interest. The petitioner's appeal was decided by the Commissioner (Appeals) partly in its favour for the assessment years 1991-92; 1992-93 and 1993-94 and fully for the assessment year 1994-95. The department preferred appeal before the Income Tax appellate tribunal.

The impugned notices were issued on a mere change of opinion that a larger sum ought to have been disallowed under the original assessment.

The case of the petitioner is that it has huge capital reserved and profits out of which it makes the investment in tax free bonds and no part of the borrowed funds was utilized in the said investments. The interest on the said bonds is fully exempted from tax. The assessing officer in making the assessment for the relevant years was of the view that as the income from bonds is exempt the corresponding expenditure is disallowable and as no separate accounts were maintained by the assessee, 10% of such interest was considered fair and reasonable as allocable to such interest. The respondent-assessing officer now on 29.05.2001 issued the impugned notices on the belief that the income has escaped assessment within the meaning of section 147 of the Act and thereby proposed to re-assess the income.

The respondent resisted the petition mainly on the ground that in the original assessment the assessing officer considered non-allowability of the expenditure attributable to the income which was not to be included in total income and on the reasonable estimate the disallowance of 10% of the tax free interest on P.S.U. Bonds were made. The assessee has not made a truthful disclosure of income in his original return as the petitioner paid interest on borrowing on the one hand and on the other hand investments were made to earn tax free income from bonds. Therefore, this is the reason for reopening of the case of the petitioner and the question for consideration is whether the interest, paid on borrowing funds which were used for earning tax free income is allowable as business expenditure. In the circumstances the assessing officer has jurisdiction to issue notices under section 148 of the Act and proceed for re-assessment.

Heard Sri S.E.Dastur, learned senior counsel for the petitioner and Sri S.K.Posti, learned counsel for the respondents.

At the outset it is desirable to reproduce section 147 of the Act which reads as below:

> **''147.Income escaping assessment-** If the assessing officer, (has reason to believe) that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which

comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in sections 148 to 153 referred to as the relevant assessment year):

Provided that where an assessment under sub-section (3) of section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section *after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment for that assessment year.(Emphasis supplied)*

Explanation 1-Production before the assessing officer of account books or other evidence from which material evidence could with due diligence have been discovered by the assessing officer will not necessarily amount to disclosure within the meaning of the foregoing proviso.

Explanation 2-For the purposes of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely:-

(a) where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous years exceeded the maximum amount which is not chargeable to income-tax;
(b) where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the assessing officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return;
(c) Where an assessment has been made, but-

(i) Income chargeable to tax has been underassessed; or
(ii) such income has been assessed at too low a rate; or
(iii) such income has been made the subject of excessive relief under this Act; or

(iv) excessive loss or depreciation allowance or any other allowance under this Act has been compute.

The above proviso to section 147 of the Act provides that reopening of the assessment after the expiry of four years' from the assessment year

would be permissible only when there is failure as prescribed on the part of the assessee. Learned counsel for the petitioner vehemently argued that there is no material as may in any way indicate or suggest that there was failure on the part of the petitioner of the kind envisaged in the proviso. Exts. 2 to 6 annexed to the petition are the copies of the assessment orders for each of the relevant assessment years. These reveal that every material fact relating to the interest earned on tax free bond was fully and truly disclosed and the assessing officer on considering the material on record and the submission of the assessee estimated the expenditure and made the disallowance to the extent of 10% . Learned counsel also argued that it was no where stated that the assessee failed to make a return or that full and true disclosure of all the material facts was not made.

On the other hand learned counsel for the respondents the justification of the impugned notices on the ground that the respondent-assessing officer has cogent reason to believe that the income has escaped assessment in view of the fact that the assessee has invested substantial amount in PSU bond for which assessee had to use funds borrowed on high rate of interest and in a situation like this the expenditure incurred and the exempt income is not allowable expenditure under the provisions of the Act. Learned counsel also submitted that this aspect was neither examined by the assessing officer at the time of the original assessment nor the assessee, has made a truthful disclosure in his original return of income as such. The reference was made to the notice under section 148 of the Act, Annexure 2 to the counter affidavit, also reproduced in the petition by the petitioner. For all the assessment years similar notices were given. We find it expedient to reproduce the same here:-

> **"Reasons for issue of notice u/s 148 in the case of M/S Oil & Natural Gas Commission for the assessment year 1991-92**
>
> Assessee filed its return of income of Rs.439, 49, 86, 580.00 and assessment under section 143(3) was completed at income of Rs.812, 37, 78, 325.00.
>
> It was noticed from the computation of income that assessee has earned interest from tax free PSU Bond which has been claimed exempt u/s 10(15(iv)(h) at Rs.152, 30, 68, 966.00. On the other hand assessee has claimed deduction on account of interest on loans from Govt. Of India/Banks and others. In order to earn the tax free interest the assessee has invested substantial

amount in PSU bonds for which assessee had to use borrowed funds of higher rate of interest. If the ONGC had not invested into the PSU bonds, there would not have been that much necessity for such borrowings. This view finds support from the ratio of judgment of Hon'ble Allahabad High court in the case of CIT Vs. H.R. Sugar Factory Pvt. Ltd., 187-ITR-363. The disallowance of interest on this point had been made by the A.O. after detailed discussion in assessment order in the case of ONGC from A.Y. 1996-97 onwards and the same has been partly confirmed in appeal by CIT (A). Now matter is pending before Ld. ITAT. With the insertion of Sec. 14A by Finance Act, 2001 w.e.f. 01.04.1962, the action taken by A.O. stood confirmed.

In view of the above, I have reason to believe that income to the tune of Rs.109, 43, 12, 086.00 has escaped Assessment within the meaning of Explanation 2©(1) of Sec. 147 of the I.T.Act. Accordingly, notice u/s 148 is to be issued.

Sd. H.C.Jain
Addl. Commissioner Of Income-
Tax, Special Range, Dehradun."

At the outset it need to be mentioned that in the reasons for reopening of assessment which have been reproduced above it has not been alleged there has been omission or failure on the part of the assessee to disclose fully and truly and the material facts necessary for the assessments. The reasons itself, in fact, indicate that the assessee has disclosed full and true facts about the borrowings of funds as well as investments made in tax free public sector undertaking bonds. The reason to believe that income has escaped assessment was that the assessing officer has, in fact, not given conscious consideration to the aspect that if the assessee had not invested into tax free bonds there would not have been necessity for borrowing of funds by assessee and by mistake underestimation of the income was made. It is, thus, obvious that the reasons shown do not satisfy the conditions as envisaged under the proviso to section 147 for reassessment.

On behalf of the petitioner reliance was placed on the apex court decision in **Parashurama Pottery Works Co. Ltd. Vs. ITO, (1977) 106, ITR 1** in support of the contention that for failure of the assessing officer in assessing the taxable income recourse to section 147 of the Act cannot legally be taken. The apex court in the reported decision has observed (page-7) that "the duty which is cast upon the assessee is to make quite true

and full disclosure of the primary facts at the time of the original assessment Production before the Income Tax officer of the accounts books or other evidence from which material evidence could with due diligence have been discovered by the Income Tax officer will not necessarily amount to disclosure contemplated by law. The duty of the assessee in any case does not extend beyond making a true and full disclosure of primary facts. Once he has done that his duty ends. It is for the Income Tax officer to draw the correct inference from the primary facts. It is no responsibility of the assessee to advise the Income Tax officer with regard to the inference which he should draw from the primary facts. If an Income Tax officer draws an inference which appears subsequently to be erroneous, mere change of opinion with regard to that inference would not justify initiation of action for reopening assessment".

The principle laid down squarely apply to the facts of the instant case and on the pretext that there was no conscious consideration of the pointed facts at the time of the assessment, reopening of the assessment is not legally permissible by virtue of proviso to section 147 of the Act.

In **McDermott International Vs.C.I.T. 259, (2003) ITR 138 (Uttaranchal)** to which one of us (Hussain J.) was a party, this court has recently held that an assessment could not be reopened when there was no failure on the part of the assessee to make a full and true disclosure of all material facts. It was reiterated that a reassessment cannot be initiated on the basis of a change of opinion and that Explanation 2 to section 147 of the Act permit reassesssment within the permissible period under section 147 whereas to carry reassessment beyond a period of four years, the conditions under the proviso have to be fulfilled. It was thus observed “According to learned counsel, the information as envisaged under the Explanation would also be decision of superior authorities and includes true and correct state of law and also information as to judicial decision. He sought to support this proposition by citing various authorities. We need not discuss the case law, even accepting the position of law as information for re-opening of assessment. It could be for invoking the provisions under section 147 of the Act. The proviso to section 147 of the Act as discussed casts exemplary burden for satisfaction that the assessment escaped only due to failure on the

part of the assessee for the contingency either of the description. In our view, information relating to the position of law available through the verdict of the higher authority could not be such failure on the part of the assessee which authorities the assessing authority to reopen the assessment".

Further, the decision of the Allahabad High Court referred by the assessing authority has no bearing to the facts of the case. The reasons are that firstly the decision does not relate to the legal proposition as contained in section 147 of the Act and secondly the decision was referred to as supportive of the changed opinion of the assessing authority, which as stated above would not justify re-assessment. Even otherwise in the said case the assessee company had advanced loans to its directors for non-business purposes. In the instant case details of cash, profits, free reserves and investments in PSU bonds as at the end of the relevant financial periods referable to the assessment years in question, as set out in Annexure Ext. 1 to the petition, reveal that the petitioner had huge reserves and case profits facilitating investments in PSU bonds. Ext.1, for the sake of convenience is also reproduced below:

DETAILS OF CASH PROFITS, FREE PESERVES AND INVESTMENT IN PSU BONDS AS AT THE END OF FINANCIAL PERIODS.

(Rupees in Crores)

Financial Year	Assessment Year	Cash Profits	Free Reserves	Total of cash profits and free reserves	Balance of Investments in tax free PSU bonds
1990-91	1991-92	2553.11	10367.43	12920.54	1545.42
1991-92	1992-93	1651.52	10849.03	12500.55	1525.65
1992-93	1993-94	1837.78	11655.52	13493.30	1592.14
1993-94	1994-95 (Commission)	2459.32	13349.01	15808.33	1592.14
1993-95	1994-95 (Corporation)	589.60	13763.20	14352.80	1592.14

On behalf of the petitioner with reference to the above financial position reliance was placed on the reported decision of Madras High Court in the matter of **Commissioner of Income Tax Vs. Hotel Savera (1999) 239 I.T.R. 795** wherein assessee-firm lent money to the private limited company and the money borrowed by the firm was mixed with its own funds and finding that the firm had sufficient funds to cover advance the presumption drawn was that the advance had been made with firm's own

funds. In the case of Shree **Digvijay Cement Company Limited vs. CIT (1982) 238 ITR 45** Gujrat High Court held that where the material on record showed that the assessee had a common fund it cannot be predicated that the money lent came only out of borrowed funds. Considering that the petitioner company had huge cash profits and reserve it has to be accepted that no part of the borrowed funds has in fat been invested in PSU bonds. The reported decision also fortify this conclusion.

Learned counsel for the petitioner has submitted that even on merit the impugned action has no legal sanctity as there was no bar against the allowance of expenditure incurred on tax free income and in support thereof reliance was placed on the decision of the apex court in **CIT Vs. Indian Bank Ltd. (1965) 56 ITR 77** and **Rajasthan State Warehousing Corporation Vs. Commissioner of Income Tax, (2000) 242, ITR, 450.** In the first mentioned case the assessee-bank was held entitled to claim the deduction of the entire interest paid by it on fixed deposits and whereas in the later case it had been held that if the assessee's business is one and indivisible, expenditure cannot be apportioned and part related to income which is exempt cannot be disallowed. In our opinion these decisions support the argument of the learned counsel that even on bare facts the assessing authority has no reason to believe that income had escaped assessment and the reopening proceedings are without jurisdiction. The observation so made with reference to the argument of the learned counsel for the petitioner and the reported decision however, has been made to question factum of the existence of the grounds for the belief and in any case, it is not in relation to the adequacy of the grounds of such belief. As the things stand the facts of the case are glaring enough to show that the reasons or ground for reopening of the assessment as envisaged by the proviso to section 147 of the Act are totally non-existent.

Learned counsel for the respondents submitted that non-disclosure of any fact which have a material bearing on the question of assessment confer power on the assessing authority to exercise jurisdiction under sections 147 and 148 of the Act and since in the instant case the petitioner has failed to disclose fully and truly the material facts with regard to the investments into tax free bonds which had necessitated borrowing of funds by it, the assessing

authority has reason to believe that the income has escaped assessment. In support of his contention, learned counsel referred to **Indo-Aden Salt Mfg. and Trading Co. P. Ltd. Vs. Commissioner of Income Tax, Bombay, (1986) 159 ITR 624; Kantamani Venkata Narayana & Sons Vs. First Additional Income Tax Officer, Rajahmundry, (1967) 63 ITR 638; Commissioner of Income Tax Vs. Miss Esther P. Carvalho & others, (1999) 237 ITR 549, Zohar Siraj Lokhandwala Vs. M.G. Kamat & others, (1994) ITR, Vol. 210, 957; Commissioner of Income Tax, Madras Vs. T.S. PL. P. Chidambaram Chettiar, (1971) 80 ITR 467** and **Seth Kishori Lal Babu Lal Vs. Commissioner of Income Tax, U.P. (1963) 49 ITR 502.**

Heaving gone through the above decisions we feel no need to discuss the facts of these cases because in totality of facts and peculiar circumstances of these cases, the two conditions which are required to be satisfied before assuming jurisdiction under the provisions of section 147 read with section 148 of the Act were found to exist and whereas in the instant case the facts and circumstances conclusively show that the reasons or ground for reopening of assessment in terms of the proviso to section.

147 are totally non-existent. In short, the above reported decisions are of no help to the cause of the respondents.

In the reasons disclosed the assessing officer also relied upon the provisions of section 14-A of the Act. Since in the counter affidavit it has been averred that the reopening of the assessment was not based on section 14-A of the Act we need not enter into any discussion about the import of the said provision. Likewise in the face of the above conclusion we do not find it necessary as to whether or not the sanction to issue notices under section 151 of the Ac t is bad in law.

For the reasons stated above, the impugned notices dated 29.05.2001 issued under section 147 read with section 148 of the Act are without jurisdiction as the conditions precedent to reopen the assessment in terms of the proviso to section 147 are totally non-existent and therefore, we allow the petition and quash the impugned notices.

(M. M. Ghildiyal, J.) (**Hon. Irshad Hussain, J.)**

26.06.2003/B.